COMTECH
GROUP INTERNATIONAL LIMITED

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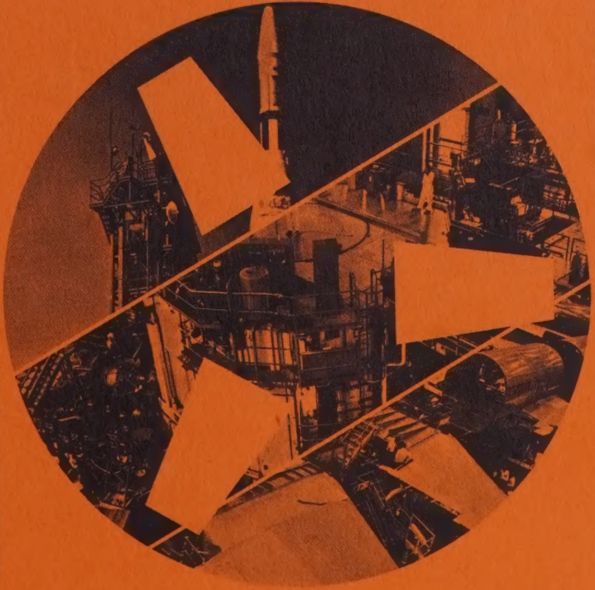
1972 ANNUAL REPORT



COMTECH

Directors

Michel Bourbonnais
J. Heath Halliday
James E. Houston
Eugene A. Kolaczynski
Edward K. Loyst
Donald M. McPhail
Sinclair M. Stevens

Officers

Sinclair M. Stevens, Chairman
Donald M. McPhail, President
J. Heath Halliday, Treasurer
Noreen M. Stevens, Secretary

Head Office

COMTECH GROUP INTERNATIONAL LIMITED
50 Lesmill Road
Don Mills, Ontario
Area Code 416 - 445-4010

Data Centres

MONTREAL DATA CENTRE

COMTECH LIMITEÉ
Suite 1000
9310 St. Laurent Blvd.
Montreal, Quebec
Area Code 514 - 384-3550

TORONTO DATA CENTRE

COMTECH (CENTRAL) LIMITED
50 Lesmill Road
Don Mills, Ontario
416 - 445-4010

Annual General Meeting

The 1972 Annual and General Meeting of Shareholders of Comtech Group International Limited will be held in the Prince Edward Island Room of the Royal York Hotel in Toronto, at 3:30 p.m. on December 7, 1972.

Highlights of Operations

	1972	1971 (Restated)
Computer service revenue	$1,239,009	$1,174,661
Package revenue	959,898	750,295
Costs and expenses	1,259,643	1,254,716
Loss before extraordinary items	13,949	162,130
Net loss	35,947	785,605
Per common share		
Loss before extraordinary items	.02	.22
Net loss	.05	1.05
Average number of shares outstanding	758,752	748,463

TO OUR SHAREHOLDERS:

1972 has been the most satisfactory year in the Company's history. It has been a year of solid constructive progress.

Here are the highlights:

1. Our annualized Canadian package processing has broken the $1 million mark within the fourth quarter.

2. There has been material improvement in the Company's earnings position as a result of rising payroll sales coupled with tight control of expenses.

3. We have successfully introduced new package products to supplement our basic payroll package.

4. The Company's financial position has been improved through an Industrial Development Bank loan, an increased bank line of credit and curtailment of our net cash outflow.

5. Future computer needs in the Toronto area have been solved through an agreement with a major utility company, which gives us ownership and use of their facility, and thereby increases our capacity by 60% with no increase in our current cost.

6. In the U.S.A., we are most pleased with the 1972 development of our association with Lykes-Youngstown Computer Services Corporation. Prior to signing our agreement with Lykes, we had lost money in our American activities. Today, we are receiving royalties rather than covering losses. In ten months, Lykes has increased what was our nucleous U.S. business of servicing 20 payrolls with a gross annual revenue of $20,000 to 100 payrolls with a gross annual volume

of $120,000. Today, they have ten salesmen actively selling our product in six U.S. cities. Lykes are working closely with banks in selling and producing the payrolls. We intend to enter into further such agreements with others for the licencing of our system, here and abroad.

Due to this basic change in marketing our product in the U.S., your directors felt they should eliminate the data centre development costs which appeared last year on our balance sheet. Accordingly, this item, which totalled $250,104 at the end of last year and which would have reached $287,387 this year, has been fully expensed in the year the costs were incurred. In our current year, this has changed marginal earnings to a loss of $35,947 and has resulted in a balance sheet deficit. We believe, however, that this more conservative form of accounting will be preferable over the coming years.

During the fourth quarter the Company introduced a new product "AUTOPAY" to enhance its coverage of the payroll market. Our new payroll product was designed to fill the need of companies with small payrolls. It handles the administrative processing problems for them, allows them to keep abreast of all government tax changes and yet is inexpensive. "AUTOPAY" has already proven itself in the market place with 20 systems having been sold. We also have increased our efforts to develop other products and expect to release them early in our next fiscal year. We expect to be able to licence our new products with even greater ease as our new application areas are concerned with international business practises and we are not affected by government legislation as is the case with payrolls.

In the coming years the Company intends to increase its concentration and effort on profitability for our shareholders, on servicing our current and future customers even better, and on the development of additional products that can find direct application among our customers.

To some it may be of interest to note that during the past year we processed over 2 million cheques having a face value of over $300 million.

I would like to thank all of the Company's employees for their effort in the past year and to thank all of our shareholders for their support through the Company's trying development period in data processing services. In the coming year we anticipate substantial profit generation and record growth in our total business.

On behalf of the board of directors.

President

November 13, 1972

ASSETS

	1972	1971 (Restated) (Note 2)
CURRENT ASSETS		
Cash	$ 841	$ 18,719
Accounts receivable	218,056	193,249
Subscriptions receivable	—	154,180
Inventories, at cost	13,674	19,098
Prepayments and advances	18,180	42,640
	250,751	427,886
FIXED ASSETS (Note 3)		
Cost	876,410	884,880
Accumulated depreciation	341,939	254,419
	534,471	630,461
PACKAGE PROGRAMME (Note 2)	129,354	121,807
OTHER ASSETS AND DEFERRED CHARGES (Note 4)	32,101	10,225
EXCESS OF COST OF INVESTMENT IN SUBSIDIARIES OVER NET ASSETS ACQUIRED (Note 1)	601,809	616,758
	$1,548,486	$1,807,137

Signed on behalf of the Board:

Director

Director

Consolidated Balance Sheet as at June 30, 1972

LIABILITIES

	1972	1971 (Restated) (Note 2)
CURRENT LIABILITIES		
Bank indebtedness and other term loans (Note 5)	$ 144,726	$ 123,645
Accounts payable and accrued liabilities	181,360	201,631
Current maturities on long-term debt (Note 6)	126,544	276,665
	452,630	601,941
LONG-TERM DEBT (Note 6)	370,606	447,149
	823,236	1,049,090

SHAREHOLDERS' EQUITY

CAPITAL STOCK (Note 7)

Authorized

14,490 5% First preference shares $10 par value, cumulative, redeemable at $10.20 a share

157,482 3% Second preference shares $1 par value, non-cumulative, redeemable at par

2,000,000 Common shares, $1 par value

	1972	1971
Issued		
4,490 5% Preference shares	44,900	44,900
55,482 3% Preference shares	55,482	55,482
760,313 Common shares	760,313	757,363
	860,695	857,745
CONTRIBUTED SURPLUS (Note 8)	—	116,857
DEFICIT	(135,445)	(216,555)
	725,250	758,047
	$1,548,486	$1,807,137

Consolidated Statement of Loss

FOR THE YEAR ENDED JUNE 30, 1972

	1972	1971 (Restated) (Note 2)
REVENUES		
Package processing and related services	$ 959,898	$ 750,295
Custom work and other	279,111	424,366
	1,239,009	1,174,661
COSTS AND EXPENSES		
Salaries and benefits	383,198	402,897
Computer operations	492,378	518,746
Marketing and administration	384,067	333,073
	1,259,643	1,254,716
Loss before taxes and extraordinary items	20,634	80,055
Provision for income taxes and minority interest		
Income taxes before reduction due to tax credits	4,140	28,650
Tax credits	(10,975)	(17,950)
Income taxes — net (Note 9)	(6,835)	10,700
Minority interest	150	1,032
	(6,685)	11,732
Loss on computer operations	13,949	91,787
Loss on discontinued automotive parts business	—	70,343
Loss before extraordinary items	13,949	162,130
Extraordinary items		
Loss on disposal of customer list	20,231	—
Loss on disposal of automotive parts business	(1,120)	487,351
Loss on disposal of fixed assets	2,214	136,124
Miscellaneous	673	—
	21,998	623,475
NET LOSS (Note 12)	$ 35,947	$ 785,605

Consolidated Statement of Retained Earnings (Deficit)

FOR THE YEAR ENDED JUNE 30, 1972

	1972	1971 (Restated) (Note 2)
Retained Earnings (Deficit) at Start of Year		
As previously reported	$ 30,500	$ 97,401
Prior years' adjustments		
Retroactive change in capitalization policy (Note 2)	247,055	97,065
As restated	(216,555)	336
NET LOSS	35,947	785,605
	(252,502)	(785,269)
Transfer from contributed surplus (Note 8)	117,057	568,714
RETAINED EARNINGS (DEFICIT) AT END OF YEAR	$ (135,445)	$ (216,555)

Consolidated Statement of Source and Application of Funds

FOR THE YEAR ENDED JUNE 30, 1972

	1972	1971 (Restated) (Note 2)
SOURCE OF FUNDS		
Operations		
Net Loss	$ (35,947)	$ (785,605)
Charges not requiring funds		
Depreciation on fixed assets	105,994	149,353
Loss on disposal of fixed assets	2,214	136,124
Loss on disposal of automotive parts business	—	487,351
Amortization of deferred charges	38,815	31,054
Loss on disposal of customer list	20,231	—
Provision for deferred taxes and minority interest	(8,300)	11,332
	123,007	29,609
Issue of common shares	3,150	16,820
Issue of 7½% convertible debentures	—	190,975
Loan from the Industrial Development Bank	50,000	—
Proceeds from sale of fixed assets	997	221,757
Proceeds from sale of automotive parts business	—	74,743
	$ 177,154	$ 533,904
APPLICATION OF FUNDS		
Purchase of fixed assets	$ 13,215	$ 4,183
Package programme development costs	44,317	30,174
Retirement of long-term debt		
Notes on computer equipment	111,544	335,469
Other	15,000	8,800
Investment in shares of subsidiaries less working capital at dates of acquisition	13,488	16,815
Investment in and advances to joint venture	4,408	—
Costs of winding up Fibre Products business	—	77,338
Miscellaneous	3,006	2,310
	204,978	475,089
INCREASE (DECREASE) IN WORKING CAPITAL POSITION	(27,824)	58,815
	$ 177,154	$ 533,904

Auditors' Report

To the Shareholders of
Comtech Group International Limited

We have examined the consolidated balance sheet of Comtech Group International Limited and its subsidiaries as at June 30th, 1972 and the consolidated statements of loss and retained earnings (deficit) and source and application of funds for the year then ended. Our examination included a general review of the accounting procedures and such tests of accounting records and other supporting evidence as we considered necessary in the circumstances.

In our opinion, these consolidated financial statements present fairly the financial position of the companies as at June 30, 1972 and the results of their operations and source and application of their funds for the year then ended in accordance with generally accepted accounting principles applied, after giving retroactive effect to the change in accounting policy with which we concur, as explained in Note 2 to the consolidated financial statements, on a basis consistent with that of the preceding year.

Toronto, Ontario,
November 7, 1972.

LAVENTHOL KREKSTEIN HORWATH & HORWATH,
Chartered Accountants.

Notes to 1972 Consolidated Financial Statements

1. ACQUISITIONS AND PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of the following principal subsidiaries:

Name of Subsidiary	Date Acquired	Percentage Owned
Comtech Group Limited	June 3, 1969	100%
Subsidiaries of Comtech Group Limited		
Comtech (Central) Limited	March 30, 1968	100%
Comtech Limitée	August 7, 1968	100%
Commercial Computer Services Inc.	November 3, 1969	99.5%
Comtech New England Inc.	May 29, 1970	100%

During the year, Comtech New England Inc. acquired a 72% interest in a newly formed corporate joint venture at a cost of $360, carried out under the name of Comtech (U.S.A.) Inc. The investment in the joint venture amounting to $4,408, has been reflected in these financial statements on the equity basis.

It is the company's policy not to amortize the "excess of cost of investment in subsidiaries over net assets acquired" since management is of the opinion that there has been no diminution of value. However, certain charges to income, such as settlements with vendors of subsidiaries, provisions for deferred income tax and minority interest, have been credited to this account since such costs have been treated as a recovery of part of the purchase price. The total amount so charged to income in 1972 was $8,200 ($11,332 in 1971) and $42,540 cumulative to date.

2. PACKAGE PROGRAMMES (DEVELOPMENT COSTS) AND CHANGE IN ACCOUNTING POLICY

In prior years, the company deferred certain data centre development costs, which it believed related to the penetration into and development of new market areas. These expenses were being amortized over a five-year period. These costs were incurred to provide for the development of the companies' own operating centres. With a change in the companies' operations to licencing, the company believes this policy no longer has application and, effective July 1, 1971, adopted the policy of writing off such expenses in the year incurred. This new policy has been given retroactive effect.

As a result of this change, the 1971 figures have been restated by charges against income and retained earnings of $153,040 and $97,065 respectively and an appropriate adjustment of the income tax accounts. Had this change not been made, the company would have capitalized an additional $48,143 during the year ended June 30, 1972 and would have reflected an amortization expense of $10,860, which would have increased net income by $37,283. (No taxes would have been exigible on this increase.)

The effect on the development costs during the year was as follows:

Balance at start of year	
Package programmes	$ 121,807
Data centre development	250,104
	371,911
Retroactive change in accounting policy of capitalizing data centre development costs	250,104
	121,807
Package programmes capitalized during the year	44,317
Amortization of package programmes	(36,770)
Balance at end of year — package programmes	$ 129,354

The company will continue to capitalize the costs of package programme development and amortize such costs over a five-year period on a straight line basis.

3. FIXED ASSETS

	1972			1971
	Cost	Accumulated Depreciation	Net	Net
Computer equipment	$ 719,807	$ 250,298	$ 469,509	$ 556,130
Magnetic tapes	36,676	22,429	14,247	18,777
Furniture and Office Equipment	100,192	51,855	48,337	44,798
Leasehold improvements	19,735	17,357	2,378	9,629
Vehicles	—	—	—	1,127
	$ 876,410	$ 341,939	$ 534,471	$ 630,461

The company depreciates its fixed assets on a straight-line basis over their estimated useful lives. Total depreciation during 1972 was $105,994 ($149,353 in 1971).

4. OTHER ASSETS AND DEFERRED CHARGES

	1972	1971
Deferred financing expense	$ 9,677	$ 9,025
Deferred income taxes (Note 9)	16,500	—
Miscellaneous	1,516	1,200
Investment in and advances to corporate joint venture (Note 1)	4,408	—
	$ 32,101	$ 10,225

Deferred financing expense represents a discount of $8,000 on the 7½% convertible debentures, expenses in conjunction with the issue of these debentures and the loan from The Industrial Development Bank. These are being amortized on a straight-line basis over a five-year period. Total amortization during 1972 was $2,045.

5. BANK INDEBTEDNESS

Accounts receivable have been pledged as security for bank indebtedness amounting to $124,726.

6. LONG-TERM DEBT

	1972	1971
Notes payable on computer equipment		
Lien notes payable on computer equipment (at interest approximating prime bank borrowing rates)		
Monthly principal of $2,122 to February, 1973	$ 16,976	$ 42,456
Monthly principal of $1,758 to October, 1973	28,128	49,224
Monthly principal of $6,122 to March, 1975	202,046	275,504
Promissory notes to computer supplier	—	156,630
	247,150	523,814
Convertible debentures payable		
7½% convertible, unsecured debentures to certain directors and senior officers	200,000	200,000
Loan Payable		
Secured loan payable to the Industrial Development Bank $1,000 principal in August, 1972, and $1,400 principal monthly from September, 1972 to July, 1975; interest payable at the rate of 9.5% per annum	50,000	—
	497,150	723,814
Less current maturities	126,544	276,665
	$ 370,606	$ 447,149

The 7½% convertible debentures mature on June 30, 1976. The debentures are convertible into common shares at $2.00 per share until June 30, 1973, $3.00 until June 30, 1974, $4.00 until June 30, 1975 and $5.00 until June 30, 1976.

The loan from the Industrial Development Bank is secured by a chattel mortgage on the assets of the companies, ranking second in priority to the companies' computer suppliers and bankers. Under the terms of the loan, the following restrictions have been placed upon the company:

i The company and its subsidiaries may not make capital expenditures in excess of $70,000 in any fiscal year;
ii The company may not declare nor pay dividends;
iii The company may not redeem preference shares;
iv The company may not make loans nor guarantees on behalf of others;
v The company may not repay any of the 7½% convertible debentures.

The aggregate amounts of principal payments required for retirement provisions in each of the next five years are as follows:

1973	$ 126,544
1974	97,306
1975	71,900
1976	1,400
1977	Nil

7. **SHARE CAPITAL**

The company has an incentive stock option plan which provides for the issuance of five-year options to officers and key employees to purchase common shares at prices approximating market values at the dates of grants. These options become exercisable on a cumulative basis 20% per year. During the years ended June 30, 1972 and June 30, 1971, the following changes with respect to the plan occurred:

	1972	1971
Options outstanding at beginning of year	29,250	35,000
Options granted ($2.25 in 1972; $1.40 in 1971)	6,000	4,250
Options exercised ($1.00 to $1.40 in 1972; $1.00 in 1971)	(2,950)	(3,800)
Options expired	(4,250)	(6,200)
Options outstanding at end of year	28,050	29,250

On the options outstanding at June 30, 1972 (20,300 until March 24, 1975, 1,750 until April 23, 1976, and 6,000 until March 22, 1977) the average option price was $1.29 per share. There are 200 shares available for future grants.

In addition, 100,000 authorized common shares have been reserved for possible issuance on conversion of the 7½% unsecured debentures.

Dividends on the 5% cumulative preference shares have been paid to June 30, 1954. Arrears of dividends amount to $40,410 on the 4,490 shares outstanding. Since the company failed to pay more than three consecutive half-yearly dividends on the 5% cumulative preference shares and more than four consecutive half-yearly dividends on the 3% non-cumulative preference shares, both classes of shares carry voting rights.

One of the subsidiary companies has unpaid cumulative preference dividends owing to minority shareholders in the amount of $5,119.

8. CONTRIBUTED SURPLUS

Balance at beginning of year	$ 116,857
Premium paid on common shares issued during year	200
	117,057
Transfer to deficit	117,057
Balance at end of year	NIL

The transfer of contributed surplus, made for the purpose of reducing the deficit balance is subject to ratification by the shareholders. Similar transfers in the amounts of $568,714 and $280,414 were made during 1971 and 1969 respectively.

9. INCOME TAXES

The company follows the tax allocation principle of providing for income taxes. Under this principle, a tax recovery debit of $16,500 has been set up in respect of losses represented by unclaimed capital cost allowances, since in the opinion of management it is virtually certain that future earnings will be sufficient to realize this amount.

The income tax credits shown in the consolidated statement of loss represent tax reductions arising from the carry-forward of prior years' losses in certain companies. At June 30, 1972, certain companies had accounting losses totalling $941,104 available to be carried forward for which potential tax recoveries have not been recognized in the accounts. Of this amount accumulated losses which may be carried forward for income tax purposes are as follows:

Amount of tax loss	Available to
$ 1,621	1973
187,744	1974
299,503	1975
126,158	1976
122,052	1977
$ 737,052	

10. COMMITMENTS

The companies are committed to annual realty and equipment rentals of approximately $33,000 until 1973, $31,000 until 1974, and $23,000 thereafter until 1986.

11. STATUTORY INFORMATION

The aggregate direct remuneration paid or payable by the company and its subsidiaries to the directors and senior officers of the company was $104,745 ($99,859 in 1971).

Total interest paid on long-term debt amounted to $48,175 ($56,283 in 1971).

12. EARNINGS PER SHARE

	1972	1971
		(Restated)
Loss before extraordinary items	.02	.22
Net loss	.05	1.05
Average number of shares outstanding	758,752	748,463

Earnings per share are calculated, after dividends on the 5% cumulative first preference shares, based upon the weighted monthly average number of shares outstanding during year. Had the common shares reserved at June 30, 1972 and 1971 for all then outstanding options and conversions been actually issued from the first of the year, there would have been no dilutive effect on earnings per share.

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